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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

NATIONAL CREDIT UNION
ADMINISTRATION BOARD AS
CONSERVATOR FOR WESTERN
CORPORATE FEDERAL CREDIT
UNION,

Plaintiff,

vs.

ROBERT A. SIRAVO, TODD M.
LANE, ROBERT J. BURRELL,
THOMAS E. SWEDBERG,
TIMOTHY T. SIDLEY, ROBERT H.
HARVEY, JR., WILLIAM CHENEY,
GORDON DAMES, JAMES P.
JORDAN, TIMOTHY KRAMER,
ROBIN J. LENTZ, JOHN M. MERLO,
WARREN NAKAMURA, BRIAN
OSBERG, DAVID RHAMY and
SHARON UPDIKE,

Defendants.

CASE NO. CV10-01597 GW (MANx)

**REPLY IN SUPPORT OF MOTION
OF OFFICER DEFENDANTS TO
DISMISS THE FIRST CLAIM FOR
RELIEF OF THE SECOND
AMENDED COMPLAINT
PURSUANT TO FED. R. CIV. P.
12(B)(6),**

Judge: Honorable George Wu
Date: June 9, 2010
Time: 8:30 a.m.

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TABLE OF CONTENTS

	Page
I. INTRODUCTION.....	1
II. THE COMPLAINT FAILS TO SUFFICIENTLY ALLEGE A BREACH OF THE OFFICERS' FIDUCIARY DUTIES.....	2
III. THE COMPLAINT'S ALLEGATIONS ARE BASED ON HINDSIGHT	5
IV. THE OFFICER DEFENDANTS PRESENTED THE "RED FLAGS" TO THE BOARD FOR ITS ASSESSMENT AND CONSIDERATION.....	6
V. THE NCUA FAILS TO CITE A SINGLE CASE HOLDING A CORPORATE OFFICER LIABLE IN THIS CONTEXT	10
VI. CONCLUSION	12

TABLE OF AUTHORITIES

Page(s)

FEDERAL CASES

Ashcroft v. Iqbal,
129 S. Ct. 1937 (2009) 5

Fed. Sav. and Loan Ins. Corp. v. Molinaro,
899 F.2d 899 (9th Cir. 1989)..... 11

In re Heritage Bond Litig.,
2004 U.S. Dist. LEXIS 15387 No. 02-ML-1475 DT (C.D. Cal. June 28,
2004)..... 11

Rubke v. Capitol Bancorp Ltd.,
551 F.3d 1156 (9th Cir. 2009)..... 6

STATE CASES

*Bancroft-Whitney Co., GAB Bus. Servs., Inc. v. Lindsey & Newsom Claim
Servs, Inc.*,
83 Cal. App. 4th 409, 99 Cal. Rptr. 2d 665 (2000) 11

Bancroft-Whitney Co. v. Glen,
64 Cal. 2d 327 (1966)..... 10

Reeves v. Hanlon,
33 Cal. 4th 1140, 17 Cal. Rptr. 2d 289 (2004)..... 11

Reid v. Robinson,
64 Cal. App. 46, 220 P. 676 (1923)..... 11

STATE RULES

Rule 12(b)(6)..... 6

FEDERAL REGULATIONS

12 C.F.R. Part 704, Appx. B (Oct. 25, 2002) 4

12 C.F.R. § 704.6(c) 3

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

The Second Amended Complaint (the “Complaint”) concedes that the Officer Defendants Robert A. Siravo, Todd M. Lane, Robert J. Burrell and Timothy T. Sidley disclosed the risks of WesCorp’s MBS investments to the Director Defendants. But the Complaint and the National Credit Union Administration (the “NCUA”) assert that, in hindsight, the Officer Defendants should have done something more to underscore or highlight those risks. Such hindsight judgments, which are inconsistent with the NCUA’s own regulations, cannot support the NCUA’s breach of fiduciary duty claim against the Officer Defendants.

The NCUA’s Opposition to the Officer Defendants’ Motion to Dismiss is based upon assertions that are not supported by allegations in the Complaint and, in some cases, are even contradicted by the Complaint. The NCUA claims in its Opposition that the Officers ignored the risks about the MBS investments, but the Complaint explicitly alleges that the Officer Defendants disclosed these risks, which it calls “red flags,” to the Board of Directors. There can be no basis for a claim that the Officers breached their duties of candor to the Board when the allegations specifically detail to the contrary.

Similarly, the NCUA spends pages listing the Officer Defendants’ fiduciary duties (as if there is any dispute over whether they are fiduciaries), without identifying any factual allegations in the Complaint that could constitute a breach of these duties. The NCUA’s allegations of breach are so conclusory as to be facially insufficient.

Finally, the NCUA goes to great lengths to distinguish the cases cited by the Officer Defendants, but offers none of its own. It is not surprising that the NCUA is unable to come up with a single case for the proposition that hindsight alone is sufficient to impose liability on a corporate officer for breach of fiduciary duty.

1 The NCUA seeks to hold both the Officer and the Director Defendants liable
2 for ignoring investment risks even though it alleges that the Officer Defendants
3 brought these risks to the Board's attention, and that the Director Defendants
4 considered these risks in making their investment decisions, which fall squarely
5 within the protection of the Business Judgment Rule. Everybody wishes they had
6 an economic crystal ball, but hindsight is 20/20 and it cannot form the basis of a
7 claim for breach of fiduciary duty. The NCUA's Second Amended Complaint
8 should be dismissed with prejudice.

9 **II. THE COMPLAINT FAILS TO SUFFICIENTLY ALLEGE A BREACH**
10 **OF THE OFFICERS' FIDUCIARY DUTIES**

11 The NCUA's Opposition is long on its description of the duties the Officer
12 Defendants owed WesCorp, but short on alleged *breaches* of those duties. The
13 Opposition is largely just a summary of the allegations in the Second Amended
14 Complaint (*see* Opp. at 1-14) that does not make any effort to respond to the
15 Officer Defendants' arguments. Indeed, the NCUA does not even argue that the
16 Complaint states a claim against the Officer Defendants until section I(D) starting
17 on page 20. The NCUA seems to think that it can survive a Motion to Dismiss as
18 long as it has enough allegations in the Complaint, even if the allegations amount to
19 nothing more than hindsight judgments that the Officer Defendants should have
20 further highlighted the risks of the MBS investments for the Director Defendants.

21 Accepting the NCUA's description of the duties of the Officer Directors, it
22 fails to identify any allegations in the Complaint that are sufficient to establish any
23 corresponding breaches of those duties. The NCUA's Opposition spends pages
24 identifying the specific duties of Defendants Siravo, Lane, Burrell, and Sidley,¹ but

25 ¹ *E.g.*, Siravo "had a duty to be candid and forthright with the WesCorp board of
26 directors" (Opp. at 6 (citing Complaint ¶ 54)); Lane "had a duty to ensure that
27 WesCorp followed sound financial practices," "to understand the risks in the
28 proposed budgets[,] and to communicate those risks to the budget committee and
the board" (Opp. at 6 (citing Complaint ¶ 55)); each of the Officer Defendants "had
a duty to be candid and forthright with the WesCorp board of directors . . . and to
disclose changes in the profitability, risk profile and dangers in WesCorp's

1 never alleges that the Officers breached those duties by, for example, failing to
2 “communicate” the risks to the Board, misleading the Board about those risks, or
3 concealing them from the Board.

4 Instead, the NCUA relies upon vague and conclusory allegations that are
5 unsupported or contradicted by the Complaint. The NCUA claims that the Officers
6 “failed to recommend appropriate concentration limits” for private label MBS and
7 Option ARM MBS investments in the highest rated AAA and AA securities (Opp.
8 at 21), but the Complaint never alleges what such concentration limits should have
9 been or that these hypothetical limits were exceeded or even approached. (*See* Mot.
10 at 9, 20.)² Further, neither the Complaint nor the Opposition suggest that the
11 Officers ever violated the NCUA’s own regulations on concentration limits (found
12 at 12 C.F.R. § 704.6(c)). (*See* Director Defendants’ Reply at § II(B)(2)(b).)

13 Although the Complaint alleges that more than 70% of WesCorp’s
14 investment portfolio purchases in 2007 were Option ARM MBS, the actual
15 concentration was 37% of the portfolio. (Complaint ¶ 122.) The NCUA never
16 alleges that this percentage was in excess of some unidentified reasonable
17 concentration limit or the NCUA’s own limits.³ Further, the ALCO books disclose
18 that the Officers tracked and limited concentration by different measures, and
19 stayed well within these limits. Although the NCUA apparently believes that the

20 investment policies” (Opp. at 8 (citing Complaint ¶ 54)); “Lane and Siravo had a
21 duty to . . . explain to the budget committee and, if necessary, the board as a whole,
22 the credit and financial risks that the budget contained” (Opp. at 9 (citing
23 Complaint ¶ 86)); and “Burrell had a duty to provide the information necessary to
24 do so to Siravo and Lane” (*id.*).

25 ² Moreover, notwithstanding the NCUA’s emphasis on the allegation that Option
26 ARM investments were “liar loans” with “reduced documents” (Opp. at 4;
27 Complaint ¶ 78), the Complaint does not, in fact, allege that the Officers (or
28 Directors) *knew* these loans were being fraudulently issued.

³ While the Complaint elsewhere alleges that a “concentration limit of 100% of
capital for CDOs” adopted by the Board was a “meaningful concentration limit[],”
(Complaint ¶ 126), we note that the \$9 billion in Option ARM MBS was only
27.7% of WesCorp’s total assets in 2007 (\$9 billion/\$32.517 billion) (Complaint ¶¶
63, 122) and 45% of its total shares and deposits in 2008 (\$9 billion/\$20 billion
total shares and deposits) (Complaint ¶¶ 64, 122).

1 Officer Defendants should have used different measures to set limits, the Complaint
2 does not allege that the limits they set were unreasonable or inappropriate, much
3 less that they were violated.

4 The NCUA claims the Officers “knew that the credit risk of private label
5 MBS purchases was not being thoroughly reviewed” (Opp. at 21), but the
6 Complaint never alleges what more the Officer Defendants should have done to
7 “review” these risks, which were in fact reviewed in the ALCO books and
8 presented to both the ALCO and the Board. (*See* Complaint ¶¶ 134-42, 145.)

9 The NCUA also claims that the Officer Defendants “did not comply with
10 WesCorp policies requiring the review of credit risk implications for new security
11 types[.]” (Opp. at 21.) But neither the Opposition nor the Complaint identify the
12 alleged policies or explain what was required. Further, neither attempts to explain
13 why Option ARM MBS was a “new” security type as opposed to a category of
14 private label MBS investments that had been a part of WesCorp’s portfolio for
15 years.

16 The NCUA further complains that “WesCorp also increased its risk in its
17 portfolio by purchasing MBS from lower tranches[.]” (Opp. at 21.) The NCUA
18 conveniently ignores, however, that the Complaint alleges these were the
19 “lower tranches” of the highest AAA and AA-rated securities. (Complaint ¶¶ 73,
20 82.)⁴ The NCUA itself permitted WesCorp to invest in securities rated as low as
21 “BBB.” 12 C.F.R. Part 704, Appx. B (Oct. 25, 2002).

22 Finally, the NCUA claims that the Officer Defendants “failed to disclose” to
23 the Budget Committee “what changes to WesCorp’s investment portfolio would be
24 required for WesCorp to meet the budgets or the additional investment risk that
25 would be required to do so” and failed to “recommend increasing WesCorp’s

26
27 ⁴ The NCUA’s assertion that the Officer Defendants “took no steps to curtail
28 WesCorp’s purchases of . . . lower tranche MBS” (Opp. at 22) is contradicted by the
Complaint (¶ 82.)

1 capital goals[.]” (Opp. at 22.) But the Complaint acknowledges that this
2 information was presented to the ALCO, which included Directors who were
3 members of the Budget Committee and which was responsible for “ the overall
4 management direction for WesCorp’s investment strategy and the types and levels
5 of risk WesCorp’s investments exposed it to.” (Complaint ¶¶ 25, 96-101.) Further,
6 WesCorp’s capital goals were well above what the NCUA required. (See Director
7 Defendants’ Reply at § II(B)(2)(d).)

8 Merely repeating these “threadbare recitals” of claimed breaches does not
9 support a claim for relief. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949-50 (2009)
10 (allegations that are “no more than conclusions[] are not entitled to the assumption
11 of truth”).⁵

12 **III. THE COMPLAINT’S ALLEGATIONS ARE BASED ON HINDSIGHT**

13 The Complaint’s allegations are based on the NCUA’s hindsight judgments
14 that, in retrospect and with an understanding of the turn the market ultimately took,
15 the Officer Defendants should have done more to highlight the risks of the MBS
16 investments for the Director Defendants so that they would have made different
17 investment decisions. (See Mot. at 12, 18, 20-21.) Such a claim does not and
18 cannot support a cause of action for breach of fiduciary duty.

19 Complete with citations to the Officer Defendants’ Motion, the NCUA
20 correctly notes that the Officer Defendants “repeatedly characterize the NCUA’s
21 allegations as ‘hindsight.’” (See Opp. at 23 (citing Opening Brief, *passim*).) The

22 ⁵ The Officer Defendants also note that the arguments raised by the Director
23 Defendants, particularly in sections II(B)(2)(b) and (c) of their Reply Brief, apply
24 equally here. While the Director Defendants present this argument within the
25 context of the Business Judgment Rule, which this Court has ruled does not apply
26 to the Officer Defendants, the underlying defects in the NCUA allegations remain.
27 The NCUA allegations that the Officer Defendants failed to propose proper
28 concentration limits (Complaint ¶ 110), for example, ignores that WesCorp was
investing in low-risk AAA and AA securities. Similarly, the NCUA alleges that at
least defendants Sidley and Burrell should have conducted “a thorough review” of
“new” security types (Complaint ¶ 132), while again ignoring that Option ARM
investments were in no way “new” for WesCorp.

1 NCUA then asserts, with no citation whatsoever, that the Complaint “alleges that
2 the Officer Defendants failed to act with reasonable care and diligence, taking into
3 account the information known to them *at the time.*” (*Id.* (emphasis added).) The
4 absence of any citation is telling and confirms that the Complaint’s allegations are
5 hindsight-based.

6 Nowhere does the Complaint allege that the Officer Defendants were aware
7 of risks or material information that they misrepresented to, failed to share with, or
8 concealed from the Board “at the time.” To the contrary, as discussed below, *see*
9 pp. 6-10, *infra*, the Officer Defendants continuously advised the ALCO and the
10 Board of the so-called “red flags” that represented risks to WesCorp’s MBS
11 investments. The NCUA’s theory that the Officer Defendants should have done
12 more than then they did to steer the Board away from these investments is entirely
13 based on hindsight. *Cf. Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1163 (9th
14 Cir. 2009) (in securities fraud case, affirming Rule 12(b)(6) dismissal where
15 allegations at issue “merely squabble[d] about the adverbs used in the” allegedly
16 false representations and where the plaintiff’s claim could be reduced,
17 “[e]ssentially,” to the argument that the defendant “should have included more
18 expressive language”).

19 **IV. THE OFFICER DEFENDANTS PRESENTED THE “RED FLAGS”**
20 **TO THE BOARD FOR ITS ASSESSMENT AND CONSIDERATION**

21 That the Officer Defendants were aware of “red flags” does not, without
22 more, state a claim for breach of fiduciary duty. These so-called “red flags” are
23 nothing more than risks about the economy and WesCorp’s investments, which the
24 Officer Defendants *presented to the ALCO and to the WesCorp Board.* (Complaint
25 ¶¶ 96-101, 136-44) The very essence of selecting investments involves weighing
26 the potential risks and rewards of a prospective investment. Here, the Officer
27 Defendants kept themselves apprised of the risks related to MBS investments, and
28 they brought those risks to the attention of the Director Defendants. According to

1 the Complaint, this is exactly what they were supposed to do. (*See e.g.* Opp. at 6-7
2 (citing Complaint ¶¶ 54, 55) (asserting that, for example, Siravo was supposed to
3 disclose to the Board “changes in the profitability, risk profile and dangers in
4 WesCorp’s investment portfolio” and Lane was responsible for disclosing “risks to
5 the budget committee and the board”).) In other words, the Officers complied with
6 their duties to keep the Board fully informed so that the Directors could consider
7 that information, assess the risks, and exercise their business judgment to make
8 what they believed to be appropriate investment decisions.

9 The NCUA bases its fiduciary duty claim on the assertion that the Officer
10 Defendants failed to take certain actions “[d]espite their knowledge of these ‘red
11 flag’ warnings.” (Opp. at 22.) But an examination of the Complaint shows that all
12 of the “red flags” identified by the NCUA in its Opposition were disclosed to the
13 Board. In other words, the very “red flags” the NCUA claims the Officers ignored
14 were, as alleged in the Complaint, disclosed to the Board:

- 15 • The NCUA claims that Siravo, Lane, and Burrell were aware of additional
16 risks because “investment credit spreads were tightening significantly.”
17 (Opp. at 13 (citing Complaint ¶¶ 96-99).)
- 18 • The Complaint alleges, however, that the “Director Defendants[]
19 attended ALCO meetings at which tightening investment credit
20 spreads and lower yields were discussed.” (*Id.* ¶ 96.) It also
21 alleges that a document describing the “inherent risks in [MBS]
22 securities” was “sent to all directors.” (*Id.* ¶ 97.) Further, it
23 alleges that in June 2006 “the Director Defendants were
24 presented with a chart showing that the investment credit
25 spreads for private label MBS had been generally shrinking
26 while the investment credit spreads required for WesCorp to
27 meet its budgeted income targets had been increasing.”
28 (*Id.* ¶ 99.)

- 1 • The NCUA claims that Siravo, Lane, and Burrell were aware that “‘good’
2 investments were becoming increasingly hard to find.” (Opp. at 13 (citing
3 Complaint ¶136).)
- 4 • The very paragraph in the Complaint cited by the NCUA
5 alleges, however, that “the Investment Department reported at
6 the ALCO meetings that investment credit spreads were
7 tightening” and that “‘good’ investments were becoming
8 increasingly hard to find.” (Complaint ¶ 136.) In other words,
9 the Directors on the ALCO were provided with information
10 about these risks.
- 11 • The NCUA claims that Siravo, Lane and Burrell were aware that “interest
12 rates were beginning to rise.” (Opp. at 13 citing Complaint ¶ 137.)
- 13 • Again, the very paragraph cited by the NCUA alleges that “the
14 Director Defendants were kept informed at the ALCO meetings
15 both of interest rates and of the status of the housing market, and
16 they were therefore aware of interest rates beginning to rise
17 significantly in 2005.” (Complaint ¶ 137.)
- 18 • The NCUA claims that Siravo, Lane, and Burrell were aware that “the
19 ‘housing bubble’ might be dangerously close to bursting.” (Opp. at 13
20 (citing Complaint ¶¶ 134, 137-42).)
- 21 • The Complaint alleges on information and belief that “the
22 Director Defendants were also aware of these warnings [that the
23 housing bubble was close to bursting].” (Complaint ¶ 134.) It
24 also alleges that “ALCO and the board were informed that the
25 rise in real estate prices was slowing and by mid-2006 they had
26 been informed that residential real estate prices were flat and
27 declining” (*id.* ¶ 138); that the ALCO packages in October and
28 December 2006, were “negative on housing” and noted

1 “escalating delinquencies and the inability of borrowers to
2 refinance” (*id.* ¶ 139); the January 23, 2007 ALCO package
3 “warn[ed] of a larger wave [of delinquencies] to come” (*id.* ¶
4 141); and the March 2007 ALCO packages “noted the doubling
5 of delinquency rates . . . and the inability of borrowers to roll
6 over balances and refinance” (*id.* ¶ 142).

- 7 • The NCUA claims that the Officer Defendants “were also aware that: (1)
8 the ‘reset shock’ experienced by Option ARM MBS loans increases their
9 credit risk; (2) the credit quality of the Option ARM MBS loan pools was
10 deteriorating; and (3) a drop in housing demand could result in a decrease
11 in real estate values and credit losses on existing Option ARM loans
12 because the borrowers would be unable to refinance.” (Opp. at 13 (citing
13 Complaint ¶¶ 120, 134).)

- 14 • The same paragraphs, however, allege that “the Director
15 Defendants were aware” of these risks and of “these warnings
16 [that the housing bubble was close to bursting].” (Complaint
17 ¶¶ 120, 134.)

18 Not only is the NCUA’s Opposition contradicted by its own allegations in the
19 Complaint, it also fails to account for the extensive information that the Officer
20 Defendants disclosed to the Directors in the ALCO books.⁶ The characteristics and
21 volume of material in the ALCO books confirms that the Board was kept fully
22 informed. (See Mot. at 7-8, 22; *see also* RJN Ex. 2 at 0113, 0115, 0123, 0125,
23 0126.) Notably, the NCUA has had control of WesCorp’s books and records for
24

25 ⁶ The NCUA claims that the ALCO books are not subject to judicial notice. (Opp.
26 at 3.) For the reasons articulated in the Director Defendants’ Request for Judicial
27 Notice and Reply to Request for Judicial Notice, which the Officer Defendants fully
28 join, judicial notice is proper here. Even without the ALCO books, the NCUA’s
claims are unsupported by the Complaint or contradicted elsewhere in the
Complaint.

1 over two years and it has never asserted that the ALCO books contained any false
2 representations or information.

3 As is clear from the Complaint and the ALCO books, *every* so-called “red
4 flag” risk identified by the NCUA was disclosed to the Board. To the extent the
5 NCUA’s case against the Officer Defendants is premised on the idea that the
6 Officers ignored the risks of WesCorp’s MBS investments (Opp. at 22), it is fatally
7 undermined by the NCUA’s own allegations. The Officer Defendants did what
8 they were supposed to do with that information: they presented it to the Board. The
9 Directors then considered that information, weighed the potential risks and rewards
10 and exercised their business judgment in making investment decisions.

11 **V. THE NCUA FAILS TO CITE A SINGLE CASE HOLDING A**
12 **CORPORATE OFFICER LIABLE IN THIS CONTEXT**

13 The Officer Defendants acknowledge that this Court has observed that they
14 are not entitled to the protection of the Business Judgment Rule in California.
15 Nevertheless, this does not mean that corporate officers may be held liable for
16 conduct based upon a judgment that, in hindsight, they should have done something
17 different. (*See* Mot. at 12-13.)

18 The NCUA cites several cases for the undisputed proposition that officers
19 have fiduciary duties that include “a duty of reasonable care, diligence and skill in
20 their work.” (Opp. at 15-16) (citations omitted.) It goes on to quote the California
21 Supreme Court’s decision in *Bancroft-Whitney Co. v. Glen*, 64 Cal. 2d 327, 345
22 (1966) that this duty requires an officer “not only affirmatively to protect the
23 interests of the corporation committed to his charge, but also to refrain from doing
24 anything that would work injury to the corporation, or to deprive it of profit or
25 advantage which his skill and ability might properly bring to it, or to enable it to
26 make in the reasonable and lawful exercise of its powers.” (Opp. at 16-17.)
27 Nowhere in the First Claim for Relief for Breach of Fiduciary Duty⁷ does the

28 ⁷ The SERP allegations that are the basis for the Fifth through Eighth Claims for

1 NCUA allege that any of the Officer Defendants did any of these things to harm
2 WesCorp.

3 The NCUA then expends considerable effort to distinguish the cases cited by
4 the Officer Defendants (Opp. at 17-18), but it fails to cite *even one* case holding
5 that corporate officers may be held liable for a breach of fiduciary duty because, in
6 hindsight, they should have further emphasized the risks that they disclosed to the
7 Board. There simply is no precedent for holding officers liable solely because, in
8 hindsight, they should have done something different. The absence of case law in
9 itself supports Defendants' position.

10 Moreover, the NCUA misses the point about the cases cited by the Officer
11 Defendants. It is not that they arise out of identical contexts. Rather, in *analogous*
12 circumstances, where courts have addressed the liability of corporate officers for
13 breach of fiduciary duty, they have required more. While these cases might not be
14 dispositive, they are instructive and persuasive.

15 By the time the NCUA's Opposition reaches Section I(C), the NCUA
16 appears to have abandoned its claim that Officers' cases are distinguishable. The
17 NCUA concedes that *Bancroft-Whitney Co., GAB Bus. Servs., Inc. v. Lindsey &*
18 *Newsom Claim Servs, Inc.*, 83 Cal. App. 4th 409, 99 Cal. Rptr. 2d 665 (2000),
19 *disapproved of on other grounds by Reeves v. Hanlon*, 33 Cal. 4th 1140, 424, 17
20 Cal. Rptr. 2d 289 (2004), *Reid v. Robinson*, 64 Cal. App. 46, 220 P. 676 (1923),
21 *Fed. Sav. and Loan Ins. Corp. v. Molinaro*, 899 F.2d 899 (9th Cir. 1989), and *In re*
22 *Heritage Bond Litig.*, 2004 U.S. Dist. LEXIS 15387, MDL No. 02-ML-1475 DT
23 (C.D. Cal. June 28, 2004) held officers liable based on wrongful or affirmative
24 misconduct or a wholesale abdication of their responsibilities. (Opp. at 19-20.)
25 The NCUA nevertheless insists, without citation, that these cases do not *limit*
26 liability to such conduct. (*Id.*) Where the authority finds liability only in cases of

27 Relief are not the basis for the First Claim for Relief, which is predicated upon the
28 MBS investment decisions made by WesCorp.

wrongful conduct or an abdication of responsibilities, and the NCUA has cited *no* cases to the contrary, it can fairly be said that the NCUA's position is unprecedented.

The Complaint does not allege that the Officer Defendants ever misled the Board, withheld information from the Board, or failed to advise the Board of the risks of its MBS investments. Instead, it alleges that, with the hindsight benefit of knowing what happened to WesCorp's MBS investments (and the MBS investments of many other financially astute investors), the Officer Defendants should have done more to dissuade the Board from making these investments. That is simply not enough to impose liability on the Officer Defendants for breach of fiduciary duty.

VI. CONCLUSION

The NCUA's second attempt to amend its complaint and state a claim against the Officers has failed. Without any legal authority on which to rely, the Complaint tries to hold the Officer Defendants liable for decisions that, at best, seem unwise only in hindsight. Taking the allegations as true, the most the NCUA can muster is that after providing the Board with detailed information about the potential risks of private label and Option ARM MBS investments, the Officers should have made different investment recommendations. Such a claim is, quite simply, not actionable. The Complaint should be dismissed with prejudice.

DATED: May 26, 2011

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